Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Cogdill	Analyst:	Kristina E. North	Bill Number:	AB 484
Related Bills:	See Legislative History	Telephone:	845-6978	Introduced Date:	February 14, 2003
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Minimum Franchise Tax/Exempts Corporations With Gross Receipts Less Than $1 Million & No Profit

SUMMARY

This bill would:

- exempt certain corporations from the minimum franchise tax (MFT); and
- require that one of the members of the Commission on Tax Policy in the New Economy be a small business owner.

PURPOSE OF THE BILL

According to the author's office, this bill is intended to relieve financial pressures on small businesses in this state.

EFFECTIVE/OPERATIVE DATE

This bill would become effective January 1, 2004, and the exemption for certain corporations from MFT would apply to taxable years beginning on or after that date.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Under current federal law, corporations generally are taxed based on their taxable income during the taxable year. A corporation's taxable income for federal purposes generally equals its gross income less deductions for the taxable year. No MFT is imposed at the federal level.

Under the Corporation Tax Law, an annual MFT (currently $800) is imposed on all corporations that are incorporated in California, qualified with the Secretary of State to do business, or corporations that are actually "doing business" in California. Every corporation subject to the MFT remains liable for that tax until the effective date of dissolution or withdrawal, or if later, the cessation of business within this state.

Board Position:			Department Director	Date
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For corporations that incorporate or qualify with the SOS on or after January 1, 2000, the MFT does not apply for the first taxable year.

THIS BILL

This bill would exempt a corporation from the MFT if, for the taxable year, the corporation:

- has gross receipts, less returns and allowances, of $1 million or less, and
- realizes no profits.

This bill would require that one of the members of the Commission on Tax Policy in the New Economy to be a small business owner.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

- Under existing law, every corporation is required to pay estimated tax for the taxable year. These payments are made in four installments, but the amount of the first installment must be at least equal to the MFT. Since a corporation would not know its eligibility for the MFT exemption proposed by this bill until the end of the year, it would be required to pay an amount equal to the MFT. Assuming a corporation was eligible for this bill's proposed MFT exemption, it would be entitled to a refund the following year.

- This bill uses the term "gross receipts, less returns, and allowances," however no definition is provided. The reduced MFT that applied to new corporations for the 1999 taxable year used and defined the phrase "gross receipts, less returns and allowances *reportable to the state*." Since this bill uses a similar, but not identical phrase, a definition should be included in this bill for clarity and to avoid disputes between taxpayers and the department.

- Although no definition is provided for "realizes no profit," the author's staff has indicated the term was intended to mean "net income." However, if this term is defined as "net income":

  1. while a corporation with a net income of $9,050 ($799 measured tax) would only pay approximately $1 more than it would have paid in measured tax ($800 MFT - $799 = $1), a corporation with a net income of $1 ($.09 measured tax) would be required to pay approximately $799 more than it would have paid ($800 MFT - $1 = $799). Thus, a "penalty" would be created, penalizing those generating a lower net income the most.

  2. taxpayers may use their currently suspended net operating loss (NOL) deduction amount to calculate their net income for the purposes of qualifying for the MFT exemption proposed by this bill. This would appear to be in direct conflict with the Legislature's intent for suspending the NOL deduction for two years. Without a clear definition, or removal of the term, this term could cause disputes between the taxpayer and the department. Depending on how "realizes no profit " is ultimately defined, these MFT taxpayers may not be required to pay anything under this bill's provisions.

LEGISLATIVE HISTORY

AB 1843 (Ackerman, Stats. 2000, Ch. 862) replaced references to “income year” with “taxable year.”

AB 10 (Correa, Stats. 1999, Ch. 64) eliminated the MFT for the first two taxable years for all corporations first incorporated or first qualified to do business on or after January 1, 2000.

OTHER STATES’ INFORMATION

The following states were chosen because of similarities in their franchise and income tax systems to California’s.

Florida: No MFT or fee is imposed.

Illinois: Corporations pay an annual franchise tax. The tax, based on the prior year’s income, can range from a minimum of $25 to a maximum of $1 million. No exemptions for income of less than $1 million are provided.

Massachusetts: Corporations pay an excise tax equal to 9.5% of net income attributable to the state, and $2.60 per $1,000 upon the value of the taxpayer’s tangible property not subject to local taxation. No exemptions for income of less than $1 million are provided.

Michigan: Business entities pay a single business tax for the right to do business. The tax is 2.3% of the adjusted tax base. Businesses making less than $250,000 in adjusted gross receipts are not required to file a return.

Minnesota: Imposes an annual fee determined by property, payroll, and sales in the state. The fee can range from $0 to $5,000. No exemptions for income of less than $1 million are provided.

New York: Imposes an annual filing fee equal to $50 multiplied by the number of members of the corporation, with a minimum fee of $325 and a maximum fee of $10,000. Some small businesses pay as little as $100, however, no exemptions are provided.

FISCAL IMPACT

The department's costs to administer this bill cannot be determined until implementation concerns have been resolved but are anticipated to be moderate.

ECONOMIC IMPACT

<u>Revenue Estimate</u>

Based on the data and assumptions below, revenue effects are as follows:

Revenue Impact Assumes Effective with Tax Years Beginning on or After January 1, 2003 ($ Millions)			
Fiscal Year	2003/04	2004/05	2005/06
Revenue Loss	-215	-140	-150

This bill does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion

In the first fiscal year 2003/04, the impact is higher due to the doubling-up effect for calendar year filers with minimum payments due in April of each tax year. “Doubling-up” means that two April 15 payments are affected in the first fiscal year (2003/04). If this bill is enacted, minimum tax payments made in April of 2003 (for taxable year 2004) would have to be refunded, and no minimum tax would be paid in April 2004 for the same taxpayer. Thus, the minimum tax payments that would have been paid for two tax years would have an impact in the first fiscal year.

The number of corporate taxpayers is estimated to be 159,000 in 2003. The number was broken out into calendar and fiscal filers (a 65/35 split – 159,000 x 65% = 103,000 returns; 159,000 x 35% = 56,000 returns). Each group of filers was multiplied by the minimum tax of $800 (103,000 calendar filers x $800 = $82 million; 56,000 fiscal filers x $800 = $45 million).

For 2003/04, the revenue impact from calendar filers is estimated to be -$83 million in 2003, and -$87 million in 2004. These amounts are added to the revenue impact from fiscal filers for 2003 of -$45 million for a total 2003/04 impact of -$215 million. The 2004/05 fiscal year is the total of calendar filers 2005 impact of -$93 million with fiscal filers 2004 impact of -$47 million for a total of -$140 million. The 2005/06 revenue impact is the total of calendar filers 2006 impact of -$98 million and the fiscal filers 2005 impact of -$50 million, which rounds up to a total of $150 million.

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